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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:
OP:E:EP:T:3

Date:

Attention:

MAR 3 1999

Legend:

Company A =
Company B =
Stock D =
Plan W =
Plan X =
Plan Y =

Dear

This is in response to your request for a ruling dated August 7, 1997, submitted by your authorized representative concerning the deductibility, under section 404(k) of the Internal Revenue Code, of dividends paid with respect to Company A Stock held by Plan X. Letters dated November 10, 1997, November 12, 1997, November 26, 1997, and July 28, 1998, supplement the request.

Company A maintains Plan X. Plan X is qualified under section 401(a) of the Code and its trust is exempt from tax under section 501(a). Plan X contains a qualified cash or deferred arrangement described in section 401(k) and uses the

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calendar year as the plan year. Plan X was originally adopted by Company B, the wholly owned subsidiary of Company A, effective January 1, 1953, as Plan Y.

Company A has amended and restated Plan X, effective January 1, 1998, in the form of an Employee Stock Ownership Plan ("ESOP"), which will constitute an ESOP as described in section 4975(e)(7) of the Code and section 407(d)(6) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and as a "stock bonus plan" which satisfies the requirements of section 401(a) of the Code. The trust under the ESOP will be exempt from tax under section 501(a) of the Code.

In connection with the restatement of Plan X into the ESOP, the "prior plan," "rollover contribution," "salary reduction" and "investment" accounts of all participants under Plan X, and all allocations thereto for the plan year ended December 31, 1997, together with all "protected benefits" (as described in section 411(d)(6) of the Code) with respect to such accounts, will be transferred directly or "spun-off" to Plan W. Plan W will be established and maintained by Company A. The provisions of Plan W will be substantially the same as the provisions of Plan X. Plan W will be qualified under section 401(a) of the Code and its related trust will be exempt from tax under section 501(a). The cash or deferred arrangement under Plan W will constitute a qualified cash or deferred arrangement as described in section 401(k).

Company A will make matching contributions to Plan X with respect to the salary reduction contributions made to Plan W pursuant to participants' salary reduction agreements. Company A may also make "regular" contributions to Plan X. Plan X will also be designed to engage in leveraged ESOP transactions and will be invested primarily in Company A Stock.

The accounts that are spun-off to Plan W will be fully vested and nonforfeitable both prior to, and at the time of, such transaction. None of the accounts which will be spun off to Plan W are invested in Company A Stock. The "prior plan" accounts contain solely amounts attributable to defined contribution plans sponsored by banks acquired by Company A which were merged with and into Plan X. The "investment" accounts contain solely amounts attributable to voluntary after-tax contributions. After-tax participant contributions are no longer permitted under Plan X and no such contributions will be permitted under Plan W.

Sections 7.10 and 8.10 of Plan X provide for distribution of cash dividends paid with respect to Company A Stock held by Plan X ("Dividends") in ways as determined by the committee

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responsible for administering Plan X ("Committee"). Among the distribution methods, dividends may be distributed, on a current basis, to ESOP participants and/or their beneficiaries in a nondiscriminatory manner. Under section 8.11 of Plan X, dividends are paid to the Trustee by Company A on the date on which the dividend is paid to the shareholders. If the dividends are distributed to the participants, the Trustee holds the dividends in a money market account in the name of the ESOP until the date on which they are distributed. Dividends would be distributed in cash to participants not later than ninety (90) days after the close of the plan year in which the dividends are paid.

It is also noted that allocations of earnings to participants' ESOP accounts will occur as of the last day of each calendar month. The monthly allocation reports will not be issued until approximately thirty (30) days after the end of the month to which the statement relates. As a result, dividends with respect to Company A Stock acquired by Plan X after the last day of the month to which the allocation report relates (and which are therefore not yet reflected on an allocation report) will not be distributed to participants or used to pay a loan to the ESOP (as discussed below). Rather, such amounts will be allocated, as earnings, to participants' ESOP other investments accounts. Future cash dividends with respect to such shares will, however, be subject to distribution or for use to pay a loan to the ESOP.

Pursuant to Section 3.1(c) of Plan W, in connection with the distribution of dividends from Plan X, unless a participant properly elects otherwise on a timely basis, his or her salary reduction under Plan W will be increased, on a dollar-for-dollar basis, in an amount equal to the dividends distributed to such participant from Plan X. However, a participant who wishes not to have his or her salary reduction increased may make a written election to that effect ("Negative Election") on a form provided by the Committee. Under this provision, unless a participant elects otherwise, his or her salary reduction will automatically increase by an amount equal to the dividends distributed from Plan X.

Section 8.10(c) of Plan X provides that the increase in each participant's salary reduction under Plan W will not result in total allocations to his or her accounts for a plan year which exceed the limits imposed by sections 402(g) and 415(c) of the Code. To the extent the increase in salary reduction would cause the limitations imposed by sections 402(g) or 415(c) to be exceeded, the Dividend will be retained by Plan X and

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allocated, as trust earnings, to the participant's ESOP other investments account.

Participants under Plan W whose salary reduction is suspended in accordance with the provisions of Section 6 thereof, due to the receipt of a hardship withdrawal, will not receive distributions of dividends. Rather, dividends attributable to their ESOP company stock accounts will be allocated as their ESOP other investments accounts as earnings.

Company A intends to pass through all dividends on Company A Stock held by Plan X to participants. With respect to the taxable years in which the dividends are passed through to the Participants, Company A intends to deduct the dividends on its federal income tax return pursuant to section 404(k) of the Code.

Based on the foregoing, the following rulings are requested:

1. Under section 404(k) of the Code, the dividends paid with respect to Company A Stock held by Plan X will be deductible by Company A for federal income tax purposes in the year distributed or paid if such dividends are paid directly to participants (or their beneficiaries) by Company A or by the Plan X trustee no later than ninety (90) days after the close of the Plan Year.

2. The deemed election by each participant to increase, on a dollar-for-dollar basis, his or her salary reduction under Plan W, and each participant's option to elect not to have such deemed increase in his or her salary reduction occur constitutes a valid section 401(k) of the Code cash or deferred election under a cash or deferred arrangement described in section 401(k) of the Code.

3. The increase in salary reduction under Plan W attributable to the "deemed election" provisions thereof will not constitute "wages" subject to federal income tax withholding under section 3402 of the Code.

With respect to your first ruling request, section 404(k)(1) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction is in addition to the deductions allowed under section 404(a).

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Section 404(k)(2) of the Code provides, in relevant part, that the term "applicable dividend" means any dividend which, in accordance with the plan provisions is paid to the plan and is distributed in cash to the participants in the plan, or their beneficiaries, not later than 90 days after the close of the plan year in which paid.

Section 404(k)(3) of the Code provides that for purposes of this subsection, "applicable employer securities" means, with respect to any dividend, employer securities which are held on the record date for such dividend by an employee stock ownership plan which is maintained by - (A) the corporation paying such dividend, or (B) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(e)(4) which includes such corporation).

Section 1.404(k)-1T, Q&A 2 of the Temporary Income Tax Regulations provides that the deductibility of dividends paid to plan participants under section 404(k) of the Code is not affected by a plan provision which permits participants to elect to receive or not receive payment of dividends.

Section 404(k)(5)(A) of the Code provides that the Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determined that such dividend constitutes, in substance, an evasion of taxation.

Based upon your representations, the subject dividends on Company A stock allocated to the plan participants' accounts will be paid to the plan participants within 90 days of the close of the plan year, if they do not elect to have the dividends retained in Plan X.

Accordingly, we conclude with respect to your first ruling request that the dividends paid with respect to Company A Stock held by Plan X will be deductible, under section 404(k) of the Code, by Company A for federal income tax purposes in the year distributed or paid if such dividends are paid directly to participants (or their beneficiaries) by Company A or by the Plan X trustee no later than Ninety (90) days after the close of the Plan Year.

With respect to your second and third ruling requests, section 402(e)(3) of the Code provides, in part, that contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the

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contributions will be made to the trust or received by the employee in cash.

Section 1.401(k)-1(a)(2) of the Income Tax Regulations provides that, generally, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(3)(i) of the regulations provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either - (A) provide an amount to the employee in the form of a cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Section 1.401(k)-1(a)(3)(ii) of the regulations provides that a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Further, a cash or deferred election can only be made with respect to an amount that would (but for the cash or deferred election) become currently available after the later of the date on which the employer adopts the cash or deferred arrangement or the date on which the arrangement first becomes effective.

Section 1.401(k)-1(a)(3)(iii) of the regulations provides that cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion. An amount is not currently available to an employee if there is a significant restriction or limitation on the employee's right to receive the amount before a particular time in the future. The determination of whether an amount is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451 of the Code.

Section 1.401(k)-1(a)(4)(i) of the regulations provides that, a qualified cash or deferred arrangement is a cash or deferred arrangement that satisfies the requirements of paragraphs (b), (c), (d), and (e) of section 1.401(k)-1 and that

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is part of a plan that otherwise satisfies the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(4)(ii) of the regulations provides that, except as otherwise provided in section 1.401(k)-1(f), elective contributions under a qualified cash or deferred arrangement are treated as employer contributions.

Section 1.401(k)-1(a)(4)(iii) of the regulations provides that, except as provided in section 402(g) of the Code and in section 1.401(k)-1(f), elective contributions under a qualified cash or deferred arrangement are neither includible in an employee's gross income at the time the cash or other taxable amounts would have been includible in the employee's gross income (but for the cash or deferred election), nor at the time the elective contributions are contributed to the plan.

Federal income tax withholding under section 3402(a) of the Code is imposed on "wages" as defined in section 3401(a). Section 3401(a)(12)(A) excepts from the definition of wages remuneration paid to, or on behalf of, an employee or his beneficiary from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust.

Accordingly, with respect to your second ruling request we conclude that the deemed election by each participant to increase, on a dollar-for-dollar basis, his or her salary reduction under Plan W, and each participant's option to elect not to have such deemed increase in his or her salary reduction occur constitutes a valid section 401(k) of the Code cash or deferred election under a cash or deferred arrangement described in section 401(k) of the Code.

We also conclude with respect to your third ruling request that the increase in salary reduction under Plan W attributable to the "deemed election" provisions thereof will not constitute "wages" subject to federal income tax withholding under section 3402 of the Code.

The above rulings are based on the assumption that Plan X and Plan W will be qualified under sections 401(a), 401(k), 409, and 4975(e)(1) of the Code, as applicable, and the related trusts will be tax exempt under section 501(a) at the time that the above transaction takes place. In addition, we are assuming that the subject shares allocated to the participants' Plan X and Plan W accounts are "applicable employer securities", within the meaning of section 404(k)(3) with respect to the subject

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dividends. We are not expressing any opinion as to whether the language of any particular amendment conforms to the requirements of sections 401(a), 401(k), or 4975 of the Code.

These rulings are also based on the assumption that the proposed dividend does not constitute, in substance, an evasion of taxation within the meaning of section 404(k)(5)(A) of the Code. We are expressing no opinion as to whether or not the disallowance of deductions provided for in that section would be applicable here.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,



Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose

CC: